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SUBJECT: U.S.-Based Peabody Moves Toward Coal Investments With USG  
Help

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11. (SBU) SUMMARY AND COMMENT: A Department of Commerce advocacy letter, and post-arranged meetings with senior Mongolian officials, have boosted the efforts of U.S.-coal mining giant Peabody Energy to be involved in development of a 6.5 billion ton coal deposit. Last week, Peabody's China-based officials met with senior Mongolian officials -- including the President, Speaker and Prime Minister -- who all reacted very positively to a possible role for the firm. There are several international companies interested in a piece of the Tavan Tolgoi coal deposit, and China and Russia have applied political pressure to get their firms in on the expected consortium. Peabody would bring strong technical and financial advantages to a consortium, but it also will win major points for its U.S. origin. Mongolia's "third neighbor" policy of developing strong links with outsiders, and especially the U.S., exists precisely so Mongolia will not be at the mercy of its two huge neighbors.

12. (SBU) However, the way forward is far from clear. Lack of infrastructure will require large investments, and politics as well as commercial factors will cause sharp maneuvering over the consortium. Moreover, populist amendments passed this summer to the minerals law will allow the government a 50% equity share in the mine, but it remains unclear whether the government would fairly pay for such a stake or ante up its share of development expenses. Wrong answers may cause international investors, including Peabody, to lose interest in major mining projects in Mongolia. END SUMMARY AND COMMENT.

Bringing Peabody to Mongolia  
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13. (SBU) Peabody Energy has been coming to Mongolia off and on for nearly two years, but it has intensified its efforts in the last six months. Peabody is particularly interested in the superb 6.5 billion ton metallurgical (coking coal) and thermal coal deposit at the South Gobi site of Tavan Tolgoi (TT). Mining licenses for the Tavan Tolgoi are held by a group of Mongolian investors -- many of them politicians or politically well-connected -- joined together as "Energy Resources." To gain access to TT's coal, Peabody will have

to be invited to join the consortium Energy Resources is putting together to provide the capital and expertise to develop the project, then have the consortium be successful in passing government hurdles (more on the latter below). While Energy Resources has not yet shown its cards on the consortium, Peabody's discussions with it and individual Mongolian investors have been very positive.

14. (U) In August, Peabody applied to the Department of Commerce's Advocacy Center for USG advocacy support for the Tavan Tolgoi project, a request which was granted. This allowed post to move beyond the advisory role previously played. Post worked with the Department of Commerce's Advocacy Center to obtain a letter of support for Peabody from Commerce Under Secretary for International Trade Frank Lavin. U/S Lavin wrote separate letters to the Ministers of Industry and Trade, Nature and Environment, and Finance, all of which have joint statutory authority to negotiate investment agreements between Mongolia and mining firms. Copies of these letters were sent under cover of an ambassadorial letter to the President, Prime Minister, and Speaker. Post would like to extend a special thanks to the Advocacy Center team for its support on this project.

15. (U) From November 6-9, senior officials of Peabody's China office visited Mongolia for meetings with government officials and Energy Resources investors. Because of the top-down and politically-driven nature of Mongolian decision making, and the flux this year on mining policy issues, post advised Peabody that any major entrant needed to start at the top and then work down through the bureaucracy. Consequently, we arranged meetings with the most senior figures in the Mongolian government and political arenas. The meeting requests generally met little resistance; in fact, Prime Minister Enkhbold's foreign policy advisor, hearing that Peabody would be in town, contacted us to ask for a meeting. In addition to

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the PM, the Peabody officials (usually accompanied by the Ambassador) met with: President Enkhbayar; Speaker Nyamdorj; Minister of Industry and Trade Jargalsaikhan; Democratic Party head Ts. Elbegdorj; Democratic MP and Chair of Standing Committee for

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Defense and Foreign Affairs Gonchigdorj; former President Ochirbat; and former President Bagabandi.

16. (SBU) The meetings began with a brief introduction by the Ambassador, in which he stated USG support for Peabody's coming to Mongolia and possible investment in Tavan Tolgoi, and noted the firm's outstanding record in the U.S. and elsewhere. The Peabody officials introduced the firm and provided briefing materials in English and Mongolian. The response of Mongolian officials was very positive at all the meetings. All officials expressed hope that Peabody would find Mongolia a good place to conduct business. In comments echoed by other officials, Speaker Nyamdorj: advised Peabody to know and abide by local laws, including the newly-amended mining law; use a local office to reach out to a wide range of politicians and government officials to establish bona fides; and not just mine coal, but add value in Mongolia in order to increase jobs and new technology. (Note: Peabody is in the process of establishing a local representative office. Peabody tells us they are willing to consider these approaches if they make commercial sense, a point post has passed on to the GOM and private firms.)

The Promise and Perils of the Mongolian Coal to Peabody  
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17. (SBU) While TT's geographic proximity to resource hungry Chinese market is alluring, development of the coal deposit, and Peabody's possible investment, face a number of severe hurdles. First, virtually all mine sites lack infrastructure, requiring large capital investments to develop the mine and get the coal (or coal-produced electricity) to customers in China. Second, Mongolia is facing strong political pressure from both its neighbors (Russia and China) to have their firms cut in on development of TT. Pressure from China, the presumptive customer of the coal or

electricity from TT, is particularly problematic. Peabody has established a good working relationship with Shenhua, the Chinese firm with PRC government support to be involved in developing TT. There are at least 14 international firms pursuing some role in TT, including Japanese firm Mitsui and Australian firm BHP Billiton. The GOM is reportedly floating the idea of an international consortium composed of the GOM, the Mongolian rights holders, Peabody (or another western firm), a Chinese firm, and a Russian company. Peabody has told us that they accept such an idea in concept and are basically interested in running the mine, and maybe a mine-mouth power plant, if the project has a clear commercial basis.

18. (SBU) In addition, TT's prospective development will take place in a troubled political environment. Civil movements have alleged widespread corruption in the awarding of exploration and mining licenses for much of Mongolia in the last few years, and questioned why foreigners should be allowed to profit from Mongolia's resources while many Mongolians remain poor and jobless. Populist pressures -- and populist sentiment among MPs themselves -- led to a windfall profits tax on copper and gold in May, and significant amendments to the minerals law in July. The new law allows the GOM to claim up to 50% of mining assets classified as "strategic deposits" (a list is pending approval by Parliament, and is expected to include TT) which were explored with state funds and 34% of assets of such deposits if they were explored with private funds. Tavan Tolgoi falls into the 50% category. The GOM has not explained what the right to take state equity will mean in practice: Will the government pay a fair market value for its share? Will it contribute to capital needs to develop the mine? What role will it have in management of the mine? At this point, the answers to these questions are unknown as regulations are developed. Unsatisfactory answers to these questions may make TT and other "strategic deposits" e commercially unattractive to companies like Peabody that would be expected to invest significant money.

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